The elimination of the buyer-bank side of the triangle from the obligation of the bank to the seller is a more difficult problem. Should the bank be able to set up against the seller equitable defences arising because of the conduct of the buyer in procuring the letter? Since the very purpose of the letter of credit is to assure the seller, the bank should be precluded from doing so, unless the seller after receiving the letter has not changed his position. Upon the offer theory it is impossible to protect the seller. On the estoppel theory it is impossible to protect the bank. On the better analysis that the letter is a bilateral contract between the bank, the buyer, and the seller with the consideration furnished by the buyer for the bank's promise to the seller, it is possible in certain cases to cut off in favor of an innocent seller equities of the bank. On the one hand it may be argued that the seller, regardless of whether he has changed his position or not, is a donee of the bank's promise or else is sufficiently identified with the buyer to be affected in all cases by the latter's conduct.[14] On the other hand it may be said that, regardless of whether the seller has changed his position or not, the whole transaction between seller and buyer, buyer and bank, and bank and seller should be treated as one transaction, and that, although the sales contract and the letter of credit are separate contracts, nevertheless the innocent seller, having given value in the same transaction, is not a donee, and is therefore in all cases to be preferred to the bank.[15] It is submitted that the better solution is to make the question of whether the seller or the defrauded bank is to be preferred depend upon the seller's change of position in the particular case. The seller has received a legal obligation of the bank. The only question is whether it is conscientious for him to enforce a clear legal right. He is innocent, but he is a donee. If he has done nothing to change his position before the bank discovers the defense the bank should be permitted to avoid the obligation. But if the seller has changed his position in good faith it is not inequitable for him to enforce his legal right, and the bank should be precluded from setting up its defense.

IS APPRECIATION IN VALUE OF PROPERTY INCOME? — A taxpayer purchases property for $10,000. The property rises in value to $15,000. It is settled that so long as the taxpayer retains the property this increase in value cannot be taxed as income.[1] It is likewise settled that even if he does sell he cannot be taxed on that portion of the increase which accrued prior to March 1, 1913 (the effective date of the Sixteenth Amendment).[2] But the increment in value accruing after March 1,

the ordinary case. Certainly it might be disastrous to the buyer to be compelled to reimburse the bank and then bring an action at law against the seller.

[14] Green *v.* Turner, 86 Fed. 837 (1898); Clay *v.* Woodrum, 45 Kan. 116, 25 Pac. 619 (1891); Maxfield *v.* Schwartz, 45 Minn. 150, 47 N. W. 448 (1890). See 1 WILLISTON, CONTRACTS, § 394. See also 3 WILLISTON, CONTRACTS, § 1518.

[15] See Price *v.* Neal, 3 Burr. 1354 (1762). See also 1 HARV. L. REV. 1; 4 HARV. L. REV. 297.

[1] See Eisner *v.* Macomber, 40 Sup. Ct. Rep. 189, 193, 197 (1920).

[2] Lynch *v.* Turrish, 247 U. S. 221 (1918). But a dividend paid out of surplus accruing to a corporation before March 1, 1913, is taxable as income to the stockholder. Lynch *v.* Hornby, 247 U. S. 339 (1918).

1913, has in the past been taxed as income for the year in which the sale is made.[3] In a recent case,[4] however, a Federal District Court held that such appreciation in value is not income and that an Act of Congress taxing it as income is unconstitutional.[5]

To support its holding the court argued that judicial decisions had, at the time of the adoption of the Sixteenth Amendment, established a definite meaning of the word "income" for purposes of constitutional and statutory construction which excluded capital increment even when realized by a sale. To sustain this proposition the court cited *Gray* v. *Darlington*,[6] a case construing the Income Tax Act of 1867,[7] and a number of state decisions holding that increase of value when realized by sale of an investment is accretion to capital and not income as between life tenant and remainderman.[8] That *Gray* v. *Darlington* did not establish a definite meaning of the word income is shown conclusively by the fact that on May 20, 1918 [9] the Supreme Court distinguished the case in deciding that capital increment may be income, while two weeks later the same court cited the case as holding that capital increment can never be income.[10] That the cases of life tenant and remainderman presented no question of constitutional or statutory construction is obvious. That they established no definite meaning of the word "income" can be demonstrated. In all of the cases the court recognized that the problem involved was not to define "income" but to determine whether the profit was the kind of income which the settlor intended to give to the life tenant.[11] The cases cited by the court refute its contention.

In support of its conclusion that increment in value cannot be constitutionally taxed as income even when realized by sale, the court cited three Supreme Court decisions as binding authorities: *Gray* v. *Darlington*,[12] *Lynch* v. *Turrish*,[13] and *Eisner* v. *Macomber*.[14] The Income Tax Act of 1867 levied a tax "to be paid annually upon the gains, profits and

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[3] See MONTGOMERY, INCOME TAX PROCEDURE (1920), 334. The British Income Tax Act, 16 & 17 VICT., c. 34, has been construed to make appreciation in the value of capital assets taxable as income only if the taxpayer deals in such assets in the course of his trade or business. Stevens *v.* Hudson's Bay Co., 101 L. T. R. 96 (1909); Tebrau (Johore) Rubber Syndicate, Ltd. *v.* Farmer, 1910 Sc. Cas. 906 (1910).

[4] Brewster *v.* Walsh, 268 Fed. 207 (Conn.). See RECENT CASES, p. 564, *infra*.

[5] The Income Tax Law of 1916. 39 STAT. AT L. 757.

[6] 15 Wall. (U. S.) 63 (1872).

[7] See 14 STAT. AT L. 477, 478.

[8] Boardman *v.* Mansfield, 79 Conn. 634, 66 Atl. 169 (1907); Carpenter *v.* Perkins, 83 Conn. 11, 74 Atl. 1062 (1910); Outcalt *v.* Appleby, 36 N. J. Eq. 73 (1882); Parker *v.* Johnson, 37 N. J. Eq. 366 (1883); Matter of Gerry, 103 N. Y. 445; 9 N. E. 235 (1886); Thayer *v.* Burr, 201 N. Y. 155, 94 N. E. 604 (1911); Graham's Estate, 198 Pa. St. 216, 47 Atl. 1108 (1901); Neel's Estate (No. 2), 207 Pa. St. 446, 56 Atl. 950 (1904); Lauman *v.* Foster, 157 Iowa 275, 135 N. W. 14 (1912); Slocum *v.* Ames, 19 R. I. 401, 36 Atl. 1127 (1896); Jordan *v.* Jordan, 192 Mass. 337, 78 N. E. 459 (1906); Mercer *v.* Buchanan, 132 Fed. 501 (1904).

[9] See Hays *v.* Gauley Mt. Coal Co., 247 U. S. 189, 192 (1918).

[10] See Lynch *v.* Turrish, 247 U. S. 221, 231 (1918).

[11] See especially Matter of Gerry, note 8, *supra*, 449, 236. For a clear and accurate analysis of the true problem involved see the statement of Lindley, L. J., in *In re* Armitage, [1893] 3 Ch. D. 337, 346.

[12] See note 6, *supra*.

[13] See note 2, *supra*.

[14] See note 1, *supra*.

income of every person . . . derived from any kind of property." Profits realized within the year from sales of real estate purchased within the year or within two years previous were specifically made taxable. In *Gray* v. *Darlington* the court, emphasizing the provision as to realty, held that a profit on bonds purchased in 1865 and sold in 1869 was not income for the year 1869 within the meaning of the Act. The court specifically stated that profits arising from a transaction begun and completed within the same year would be income for that year;[15] it also treated the provision as to realty as constitutional. In view of these facts it is submitted that, in spite of certain loose language, the case is simply one of statutory construction and does not contain even a *dictum* on the constitutional question for which it was cited. *Lynch* v. *Turrish* correctly decided that capital increment accruing before March 1, 1913, cannot be taxed as income. But Mr. Justice McKenna, after disposing of the case, added to his opinion a *dictum* to the effect that *Gray* v. *Darlington* had decided that capital increment can never be taxed as income.[16] It is submitted that this statement was unwarranted and cannot be supported. *Eisner* v. *Macomber* is important only for its *dicta*.[17] The court said,[18] "Income may be defined as the gain derived from capital, from labor, or from both, provided it be understood to include profit gained through a sale or conversion of capital assets." Accepting this definition literally it is decisive against the contention of the court in the principal case. That Mr. Justice Pitney meant what he said is shown by his *dictum* that the proceeds of stock distributed as a dividend may be taxed as income when the stock is sold.[19] His subsequent statement that "enrichment through increase of capital investment is not income in any proper meaning of the term" was given in reply to the government's contention that such increase is income even before severed from capital and converted into cash.[20] It simply states that unsevered and unrealized capital increment cannot be treated as income. One other case, not cited by the court, should be mentioned, *Hays* v. *Gauley Mt. Coal Co.*[21] Conceding that it does not arise under an income tax act it nevertheless holds that "income" may be used in a sense broad enough to include capital increment.[22]

From these authorities three conclusions seem justified. First, the Supreme Court has made a number of loose and inconsistent statements some of which must necessarily be repudiated. Second, the court has used the word "income" in a sense broad enough to include capital increment. Third, the constitutional question has not been decided.

The case accordingly should be decided on principle. The situation, briefly stated, is this. Economists have not agreed upon a definition of

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[15] See note 6, *supra*, 65.

[16] See note 2, *supra*, 231. Mr. Justice Brandeis and Mr. Justice Clarke concurred only in the result.

[17] The case holds that an Act of Congress taxing stock dividends as income is unconstitutional.

[18] See note 1, *supra*, 193.

[19] See note 1, *supra*, 195.

[20] See note 1, *supra*, 196.

[21] See note 9, *supra*. The case holds that capital increment must be included in determining "gross income" under the Corporation Tax Act of 1909.

[22] See Edward H. Warren, "Taxability of Stock Dividends as Income," 33 HARV. L. REV. 885, 896.

the word "income." [23] Courts had not at the time of the adoption of the Sixteenth Amendment nor have they to-day adopted a definite construction of the term.[24] The Supreme Court has recognized that the word must be defined as used in common speech.[25] Finally Congress, a coördinate branch of the federal government, has expressly enacted that capital increment is income.[26] This last factor should be decisive. It is a settled principle of constitutional construction that a legislative interpretation of the Constitution is entitled to the greatest respect and that no act of Congress will be declared unconstitutional if it is consistent with any reasonable interpretation of the Constitution.[27] It is submitted that a definition of income to include all increases in the taxpayer's financial resources which come to him from his labor or from his property is not so broad as to be deemed unreasonable. It follows that to declare unconstitutional an act of Congress taxing capital increment as income when realized by sale is not only to infringe upon a well established rule of constitutional construction but to strike a blow at the foundation of our institutions as well. The attitude of the majority of the court in *Eisner* v. *Macomber* in riding rough-shod over Congress' interpretation of the Sixteenth Amendment raised a storm of criticism; [28] a declaration that capital increment cannot be taxed might well be followed by a constitutional amendment recalling the decision.[29]

REPEAL OF TAX EXEMPTIONS, AND THE CONTRACT CLAUSE OF THE FEDERAL CONSTITUTION. — A legislative enactment exempting property from taxation *in futuro* may constitute a contract, with the result that a repeal of the exemption by a subsequent legislature would violate the contract clause [1] of the Federal Constitution.[2] More than half a century

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[23] See SELIGMAN, THE INCOME TAX, 2 ed., 19. For an excellent analysis taking the view that capital increment is income provided there is separation and realization, see Edwin R. A. Seligman, "Are Stock Dividends Income?" 9 AM. ECON. REV. 517. This seems to have been Mr. Justice Pitney's theory in Eisner *v.* Macomber, note 1, *supra*.

[24] In Massachusetts capital increment is taxable as income. Trefry *v.* Putnam, 227 Mass. 522, 116 N. E. 904 (1918). *Contra*, State *ex rel.* Bundy *v.* Nygaard, 163 Wis. 307, 158 N. W. 87 (1916).

[25] See note 1, *supra*, 193.

[26] See Income Tax Act of 1913, 38 STAT. AT L. 167; Income Tax Act of 1916, 39 STAT. AT L. 757; Income Tax Act of 1918, 40 STAT. AT L. 1065.

[27] See Ware *v.* Hylton, 3 Dall. (U. S.) 199, 237 (1796); Cooper *v.* Telfair, 4 Dall. 14, 18 (1800); Fletcher *v.* Peck, 6 Cranch (U. S.) 87, 128 (1810); Ogden *v.* Saunders, 12 Wheat. (U. S.) 213, 270 (1827); Sinking Fund Cases, 99 U. S. 700, 718 (1878). See COOLEY, CONSTITUTIONAL LIMITATIONS, 7 ed., 252. See James B. Thayer, "The American Doctrine of Constitutional Law," 7 HARV. L. REV. 129, 138.

[28] See Thomas Reed Powell, "Stock Dividends, Direct Taxes, and the Sixteenth Amendment," 20 COL. L. REV. 536, 538.

[29] The desirability of a tax on capital increment has been pointed out. See Edward H. Warren, note 22, *supra*, 900. See also Charles E. Clark, "Some Income Tax Problems," 29 YALE L. JOUR. 735, 738.

[1] See UNITED STATES CONSTITUTION, Art. I, Sec. 10, § 1, "No State shall . . . pass any . . . law impairing the obligation of contracts."

[2] See cases in note 12, *infra*.